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**Paper for the House Committee**

**Report of the Subcommittee on  
Companies Ordinance (Exemption of Companies and Prospectuses  
from Compliance with Provisions) (Amendment) Notice 2011**

**Purpose**

This paper reports on the deliberations of the Subcommittee on Companies Ordinance (Exemption of Companies and Prospectuses from Compliance with Provisions) (Amendment) Notice 2011 (L.N. 143 of 2011) ("the Amendment Notice").

**Background**

2. Every prospectus offering shares or debentures to the public must comply with various requirements under the Companies Ordinance (Cap. 32) ("CO"). Sections 38(1) and 342(1) of CO respectively provide that every prospectus issued by local companies and companies incorporated outside Hong Kong must set out the reports specified in Part II of the Third Schedule to CO. It is unlawful to issue the prospectus without such compliance.

3. Under paragraph 34 of Part II of the Third Schedule to CO, a valuation report has to be set out in a prospectus to contain specified particulars with respect to all interests in land or buildings ("property interest") of a company and its subsidiaries ("the group"), if the property interests have a value exceeding 10% of the group's asset or have a value not less than HK\$3 million as disclosed in the group's last accounts. The Securities and Futures Commission ("SFC") and the Hong Kong Exchange and Clearing Limited ("HKEx") have received comments from the market that, in some cases, such requirement may be unnecessarily costly and

unduly burdensome, and some of the particulars provided may not be useful to investors. In December 2010, SFC and HKEx published a joint consultation paper on proposed changes to relax property valuation requirements under CO and the Listing Rules in order to invite views from the public and stakeholders, including market practitioners, companies, and issuers. Results of the consultation published in October 2011 indicated that most respondents supported the proposals.

### **Companies Ordinance (Exemption of Companies and Prospectuses from Compliance with Provisions) (Amendment) Notice 2011**

4. Under sections 38A(2) and 342A(2) of CO, SFC may, by notice published in the Gazette, exempt any class of prospectuses issued by companies from any or all of the requirements of sections 38(1) and 342(1) of CO respectively. The Companies Ordinance (Exemption of Companies and Prospectuses from Compliance with Provisions) Notice (Cap. 32 sub. leg. L) ("the Notice") sets out the class exemptions that have been granted by SFC pursuant to sections 38A(2) and 342A(2) of CO.

5. The purpose of the Amendment Notice is to amend section 6 of the Notice to provide for class exemptions to allow different valuation and disclosure requirements to apply to different property interests depending on whether they are the subject matter of business activities that involve holding (whether directly or indirectly), purchasing or developing properties for sale, letting or retention as investments ("property activities interests") or the subject matter of other business activities ("non-property activities interests"), subject to certain conditions. Details of the proposed exemptions and the conditions are summarized in the ensuing paragraphs.

6. Under the Amendment Notice, a company will be required to obtain a valuation report as to the value of each property interest which is not:

- (a) a property activities interest which has a carrying amount of less than 1% of the group's total assets provided that the carrying amounts of all such interests when added together do not exceed 10% of the group's total assets;
- (b) a non-property activities interest which has a carrying amount of less than 15% of the group's total assets; or

- (c) a non-property activities interest which is ancillary to the exploration or extraction of minerals or petroleum products with a carrying amount of 15% or more of the group's total assets and the prospectus contains a report from an independent qualified valuer regarding the valuation, as a business or operating entity, of such mining property interest together with its associated minerals or petroleum resources or assets,

(each an "exempt property interest").

7. Full text of the valuation report with respect to each property interest which is not an exempt property interest will be required to be disclosed in the prospectus except where summary disclosure is allowed. Section 6(4) of the Amendment Notice sets out the specified particulars that must be contained in the valuation report. These include the current planning and zoning use, and details of title and ownership of the interests, etc.

8. An overview with respect to all exempt property interests which are not covered by a valuation report set out in the prospectus will be required to be included in the prospectus. Section 6(5) of the Amendment Notice sets out the specified particulars that must be set out in the overview. These include the total number, the nature, and the approximate size range of the property, etc.

9. Summary disclosure in prospectus will be allowed for each property activities interest which is not an exempt property interest and has a value of less than 5% of the aggregate value (as determined by an independent qualified valuer) of all property activities interests which are not exempt property interests ("summary property activities interests"). Section 6(6) of the Amendment Notice sets out the specified particulars that must be set out in the summary. These include the geographical region of the location of the property, a brief description of the property and its use, etc. The company is required to provide for public inspection the full text of the valuation report with respect to each summary property activities interest which is not covered by a valuation report set out in the prospectus.

10. The Amendment Notice was tabled in the Legislative Council on 26 October 2011 and will come into operation on 1 January 2012. According to SFC, the proposals in the Amendment Notice will apply to prospectuses of companies in Initial Public Offers ("IPOs"). HKEx will amend the Listing Rules to mirror the exemptions in the Amendment

Notice. The amended Listing Rules will take effect on 1 January 2012. Section 38A(1) of CO provides that SFC may, on the request of the applicant, exempt the applicant from compliance with any or all the requirements under the section if it considers that the exemption will not prejudice the investing public and compliance with any or all of these requirements would be irrelevant or unduly burdensome or is otherwise unnecessary or inappropriate. For listing applicants, they may also apply for a waiver from strict compliance of the property valuation requirements under CO and the Listing Rules. SFC and HKEx will consider waiver applications on a case-by-case basis.

### **The Subcommittee**

11. At the meeting of the House Committee on 4 November 2011, a subcommittee was formed to study the Amendment Notice. Under the chairmanship of Hon James TO Kun-sun, the Subcommittee has held five meetings. The membership list of the Subcommittee is in **Appendix I**.

12. To allow more time for the Subcommittee to study the Amendment Notice, the scrutiny period has been extended to 14 December 2011 by a resolution of the Legislative Council passed on 16 November 2011.

### **Deliberations of the Subcommittee**

13. Members of the Subcommittee have discussed with representatives of SFC and the Administration a number of issues relating to the Amendment Notice. The deliberations are set out in the ensuing paragraphs.

#### Background and rationale of the Amendment Notice

14. Noting that the existing property valuation requirement (with the threshold of 10% or HK\$3 million) under paragraph 34 of the Third Schedule to CO have been in place for years, members of the Subcommittee have enquired about the background and reasons for introducing changes to the requirement, and the considerations for making the proposed requirements in the Amendment Notice.

15. SFC has advised that the existing property valuation requirement was enacted on 1 March 1973 pursuant to the Companies (Amendment) Ordinance 1972. The Companies Law Revision Committee ("the

Committee") in its First Report published on 24 June 1971 considered that valuation of property interests of companies should be made statutory since land in Hong Kong were of extremely high value resulting in it being one of the major items in the balance sheets of most large companies. While the Committee recommended that a valuation should be required in every case where the value of land and buildings owned by a company as stated in the prospectus exceeds 10% of its assets or HK\$1 million, whichever was the less, it had not explained the rationale for setting such threshold. SFC has also advised that the threshold of 10% or HK\$3 million was introduced in the Companies (Amendment) Ordinance 1972 which was later enacted in 1973. There is no public record of the rationale for increasing the threshold from HK\$1 million to HK\$3 million. The property valuation requirement and its threshold have remained the same since the enactment. SFC has further advised that over the years, there have been changes in the nature of business of companies seeking listings in Hong Kong. "Land" as one of the major items in the balance sheet of most large companies is no longer true for most listing applicants coming to the Hong Kong market in recent years. The existing property valuation requirement which do not differentiate whether the property interests are the listing applicant's core business should be changed to cater for the development in the Hong Kong market. As regards the rationale for setting the proposed requirements, SFC has advised that in formulating the proposals, SFC and HKEx held focus group meetings with key stakeholders to gather their views on the initial proposals. These included the Public Shareholders Group to solicit their views on the proposals. Participants generally supported these proposals. Results of the joint consultation conducted in late 2010 also revealed that most respondents supported the proposals. SFC and HKEx believe that the proposed requirements have struck an appropriate balance between relieving burden on companies/listing applicants and provision of sufficient valuation information to investors.

#### Benefits of the proposed amendments in the Amendment Notice

##### *Benefits for companies and listing applicants, and Hong Kong as an international financial centre*

16. SFC has explained to the Subcommittee that the valuation and disclosure requirements in CO will apply once the total value of a listing applicant's property interests exceed the threshold of HK\$3 million or 10% of assets. Once triggered, the valuation requirement will apply to each and every property interest regardless of its value, its materiality to the business of the listing applicant or the relevance of the valuation report to investors' understanding and assessment of the business. Except for valuation reports

for operating leases where the value has been determined to be zero, the valuation report must be included in the prospectus. The cost of obtaining independent valuations for property interest would be a significant burden to companies, in particular international corporations seeking listings in Hong Kong. These corporations are from diverse industries and sectors and have property interests outside Hong Kong. The existing valuation and disclosure requirements are the major disincentive for these companies to list in Hong Kong. Therefore, relaxation on the requirements would not only help reduce compliance cost on companies, but also enhance Hong Kong's competitiveness as an international listing venue.

17. Members of the Subcommittee have enquired how the proposed exemptions in the Amendment Notice would relieve the cost burden on companies. To illustrate the benefits of the proposed exemptions on listing applicants, SFC has provided information on the property activities interests and non-property activities interests of 18 companies with different core business that were listed in Hong Kong in the last three years ("the 18 listed companies") (**Appendix II**). Some of these companies have been granted waiver from complying with all/some of the valuation requirements for prospectuses. Subcommittee members noted that in one case, the listing applicant (a Mainland bank; Company 6 in Appendix II) had over 46 000 properties (mainly included branches in nine jurisdictions providing services to customers) that in total represented less than 2% of its assets. While the listing applicant's business was not related to property activities, the company would, under the existing valuation requirements, have to conduct independent valuation on each of the over 46 000 properties and set out the details in the prospectus. With the proposed exemptions under the Amendment Notice, the company would not be required to obtain valuation report on each of the property but only need to provide an overview on the properties in the prospectus. SFC has explained that there are numerous property interests held by many large international companies whose core businesses do not involve property activities, and such interests often spread over many jurisdictions. The cost of obtaining independent valuation for each and every of the property interests would be very significant not only in terms of financial cost but also in terms of time required. From the information obtained by SFC on valuation costs of the 18 listed companies provided by market practitioners, Subcommittee members noted that for one international company engaging in mining activities with approximately 2 500 property interests in 30 jurisdictions (Company 3 in Appendix II), valuations of all its property interests would cost about US\$3 million and the prospectus would have needed to include some 2 000 pages of valuation reports. Another case was an international retailer with over 300 property interests in 30 jurisdictions

(Company 1 in Appendix II), it was estimated that valuations would cost about US\$250,000 to US\$300,000, and the prospectus would have needed to include some 100 pages of valuation reports. Members further noted that among the 18 listed companies there were three companies with non-property activities the total of which were more than 30% of the total assets of the companies (Companies 10 - 12 in Appendix II). SFC explained that these property interests were mainly plants and structures built for companies to generate their products for sale. In relative terms the value of the largest two individual property interests represented only 3.1% or 1.4% of the company's total assets. These were purpose built plants and the values of the property interests were based purely on their use. No other individual property interest exceeded 1% of total assets. Members noted that under the proposed exemptions, these companies would not be required to obtain valuation reports for the property interests as they presented immaterial portion of the companies' total assets. The companies would only be required to include an overview on the property interests in the prospectuses.

18. The Subcommittee is keen to ensure that the valuation and disclosure requirements in prospectuses are on par with those in other major markets so that Hong Kong's competitiveness as an international financial centre would be maintained. In this regard, members have enquired about the situations in other jurisdictions. SFC has advised that according to a review conducted by itself and HKEx on the prospectus requirements in Hong Kong and other places (i.e. Australia, the United States, the Mainland, the United Kingdom ("UK") and Singapore); Hong Kong's regime is the most stringent as it is the only jurisdiction that requires valuations for all property interests of listing applicants. In the Mainland, valuation is only required where funds raised are used to acquire assets. Whereas in Singapore and UK, valuations are only required for principal (for Singapore) or material properties (for UK) relating to property activities. Upon further enquiry by members, SFC has advised that "principal" or "material" properties are not defined in UK and Singapore regimes with any prescribed percentage thresholds in valuation requirements.

#### *Benefits for investors*

19. SFC has advised that the proposed exemptions would benefit investors. According to SFC, while a company/listing applicant may have numerous property interests, not all of them may be material to its business. Moreover, property valuation reports may not be relevant or necessary for investors if property development and investment is not the

company's/listing applicant's core business. For instance, the property interests of a company/listing applicant engaging in manufacturing may comprise its factories. Valuation information on these properties may not be meaningful to investors as the property interests are not intended for sale or development. As such, requiring valuation reports for all property interests and disclosing them may result in pertinent information on material property interests being buried and not being readily apparent to investors reading the prospectus. SFC has stressed that for information to be useful to investors it should focus on what is relevant to investors' decisions. The Amendment Notice is in investors' interest as it would enhance the quality of information provided to investors by differentiating the circumstances in which a valuation report must be obtained for a company's/listing applicant's property activities and non-property activities and imposing different disclosure requirements in the prospectus.

20. SFC has also advised that individual valuations reports on numerous properties would be voluminous thus making prospectuses lengthy. In this regard, Subcommittee members noted that the length of prospectuses of the 18 listed companies vary between 1 732 and 453 pages. Even excluding the extreme examples, the average is over 600 pages. Members noted from the information provided by market practitioners that Hong Kong prospectuses are significantly longer than the norm in other leading financial markets by some 100 to 200 pages. Given that a listing applicant will print around 30 000 copies of a prospectus (10 000 in English and 20 000 in Chinese) and the number of copies can be considerable higher for the largest IPOs, for every 100 pages required for valuation reports, at least 3 000 000 pages will be printed. SFC and HKEx consider that production of bulky prospectuses is not conducive to environmental protection. The unnecessary length of prospectus also does not serve the interests of investors.

#### Measures to enhance wider use of electronic means in the dissemination of company information

21. Subcommittee members acknowledge that there are benefits in reducing the bulk of prospectuses which will promote protection for the environment, enhance sustainability in the securities market, and facilitate investors. While the Amendment Notice will require companies to provide for public inspection the full text of the valuation report with respect to each summary property activities interests which is not covered by a valuation report set out in the prospectus, the Subcommittee has noted that investors/interested parties have to go to the office of a company to inspect such reports and such method will be inconvenient to investors. The

Subcommittee considers that dissemination of company information through wider use of electronic means will help reduce compliance cost on companies while ensuring protection for investors in the long run. Subcommittee members therefore urge SFC to explore possible means to enhance the use of electronic means in the provision of prospectuses and the valuation reports, including uploading the valuation reports attached to a prospectus or the whole set of prospectus onto the website of a company, in order to provide convenience to investors and save papers in publishing prospectuses and attached documents.

22. SFC has explained that under the proposals in the Amendment Notice, summary property activities interests are subject to valuation. Instead of disclosing in the prospectus the full valuation report for these interests, a summary will be permitted. The information contained in the summary will be information extracted from the full valuation report. Such information should give investors a fair understanding of the interests, and generally there will be little need for investors to go to the listing applicant's office to inspect the full valuation report. Regarding the suggestion to require companies to provide prospectuses through electronic means, SFC has advised that this is not provided in the law. Section 39B of CO which permits a prospectus to consist of more than one document in accordance with the provisions of Part 1 of the Twenty-first Schedule is to facilitate the conduct of programme offers (i.e. offers made on a repeat or continuous basis or through successive tranches). This provision is not applicable to a prospectus and a separate electronic part containing a valuation report as they are not programme and issue prospectuses. Thus the separate electronic part will not be regarded as part of the prospectus as it is not contained in the prospectus as one document. Nonetheless, SFC has taken measures to allow electronic means for dissemination of prospectuses. In April 2003, SFC issued the "Guidelines for Electronic Public Offerings" to enable electronic public offerings to take place. In February 2011, a class exemption under section 9A of the Companies Ordinance (Exemption of Companies and Prospectuses from Compliance with Provisions) Notice (Cap. 32 sub. leg. L) was enacted. Under the class exemption notice, a listing applicant is permitted to issue paper application forms with electronic copies of the relevant prospectus. While requiring companies to make available the full valuation report through electronic means raises a number of issues which require due consideration, SFC will coordinate with HKEx to explore and consult on the feasibility of making valuations available on a website. In the longer term, SFC will also study the feasibility of incorporation by reference and other measures to reduce the bulk of the prospectuses.

## Protection of investors' interests

### *General disclosure obligation of companies/listing applicants*

23. While Subcommittee members appreciate that relaxation on the valuation and disclosure requirements in prospectuses would relieve the burden on companies, enhance Hong Kong's attractiveness as an international listing venue, and raise the quality of information provided to investors, they consider it of paramount importance that the proposed exemptions should not undermine the investors' interest of having sufficient and comprehensive valuation information on property interests of companies.

24. SFC has stressed that the Amendment Notice would be in the investors' interest as they will be provided with information that is focused and presented in a more meaningful manner. In addition, there is a general disclosure obligation in CO (under paragraph 3 of the Third Schedule to CO) and the Listing Rules, which required companies/listing applicants to ensure that the prospectus contained sufficient particulars and information to enable a reasonable person to form as a result thereof a valid and justifiable opinion of the shares or debentures and the financial condition and profitability of the company at the time of the issue of the prospectus, taking into account the nature of the shares or debentures being offered and the nature of the company, and the nature of the persons likely to consider acquiring them. Therefore, even with the proposed exemptions in the Amendment Notice, if particulars and information on a company's/listing applicant's property interests are necessary for investors to make an informed decision, the company/listing applicant must disclose such information in the prospectus.

### *Suggestions to improve the proposals in the Amendment Notice*

25. Subcommittee members recognize the benefit of providing "material information" on companies to investors to enable them to make informed judgement on the companies and decisions on investment. Nonetheless, they are concerned that the use of a company's properties and even its core business may change over time. For instance, while a production plant of a manufacturing company would be regarded as a non-property activities interest of the company, there would be potential for the land on which the plant was built to become a property activities interest since the company may expand its business to cover property development or sell the land for housing development. Hon James TO, Hon WONG Ting-kwong and Hon CHIM Pui-chung consider that property

activities interests are often significant assets of a company even property development is not the core business of the company. Valuation and disclosure requirements for such interests in the prospectuses are essential to facilitate investors in making informed decisions on investment.

26. Hon James TO has expressed concern that under the Amendment Notice, a company with non-property activities interests and if the carrying amount of each such interest is below 15% would only be required to provide in the prospectus an overview of the property interests, and neither valuation report nor summary would be required. He considers that the overview on the property interests covering particulars such as the total number and general description of the location, is too general and unable to reflect the current and potential value of the interests. In this regard, he noted from the example of the three companies with non-property activities among the 18 listed companies (Companies 10 - 12 in Appendix II) that although each individual property interests represented an immaterial portion of the total assets of the companies, the aggregate amount was over 30% of the companies' total assets. The significant amount may have impact on the companies' profit potentials. He is not convinced that only an overview on such significant portions of the companies' assets should be provided in the prospectuses. He has urged SFC to consider putting in place additional thresholds on valuation requirements for companies with non-property activities interests. A possible option is to require a company to provide a summary report instead of an overview on each individual non-property activities interest, if all such interests adding together have a value exceeding 15% of the total asset of the company. In respect of companies with property activities interests, Hon James TO has suggested that for those interests which are exempted from the full valuation report requirement in the prospectus, a lower threshold should be adopted on the requirement to provide a summary on the property interests, so that more companies will be required to provide a summary instead of just an overview on such property interests.

27. On the concern that prospectuses may not be able to reflect potential value of property activities interests of companies, SFC has responded that the general disclosure obligation under paragraph 3 of the Third Schedule to CO will ensure provision of sufficient information on the property and non-property activities interests of a company to investors. Besides, the Amendment Notice will not preclude companies/listing applicants from disclosing valuation information on a voluntary basis. Companies/listing applicants can include in the prospectuses valuation information they consider relevant to investors' decisions. In addition, Sections 40 and 40A of CO impose civil and criminal liabilities on persons

making untrue statements in prospectus which include omission of material information. Hence, there are safeguards against misstatements in prospectuses for protection of investors' interests.

28. As regards the suggestions to put in place additional thresholds on disclosure requirement for non-property activities interests and to lower the threshold requirement for summary disclosure on property activities interests, SFC has agreed to consider them.

29. At the meeting on 1 December 2011, SFC advised the Subcommittee that it had considered members' suggestions with further analysis on the information of the three companies with non-property activities among the 18 listed companies (Companies 10 - 12 in Appendix II). SFC opined that valuation for individual property interest was clearly irrelevant for the non-property activities interests of these companies since the valuation surplus as a percentage of total assets was minimal (valuation surplus refers to the valued amount minus book value based on cost). The valuation surplus for non-property activities interests were typically not significant and would not be reflected in the current or future financial statements of the companies. SFC therefore considered that there was no need to change the proposals for non-property activities interests. As regards requirements for property activities interests, SFC advised that under the Amendment Notice, 90% of the property interests of a company's property activities were still required to be valued. The properties that may enjoy the proposed exemption from the valuation requirement (i.e. only need to provide an overview) would at most be 10% of the company's total assets, and the value of any such individual property must not exceed 1% of the company's total assets. From the analysis of five companies with property activities among the 18 listed companies (Companies 13 - 17 in Appendix II), SFC found that although the percentage of exempted property interests in the cases varied, the relative value of property interests that would not be valued and would be reported in an overview was small. In most cases, the companies would still need to value over 95% of the total value of their property interests. The single largest property interest being exempted under the proposals was less than 0.5% of the total valued amount. Even if the threshold of 1% was lowered to 0.5%, none of the exempted property interests under the proposals would require a valuation. As illustrated in the examples, the proposed exemption in the Amendment Notice could eliminate the need for valuation for quite a large number of properties which accounted for a very small percentage of the company's total assets. When the locations of these exempt properties spread across a wide area, the savings or facilitation to companies/listing applicants could be significant.

30. At the Subcommittee meeting held on 1 December 2011, Hon James TO re-iterated his reservation towards the proposals in the Amendment Notice. He was concerned that the relaxed valuation and disclosure requirements could not accurately reflect the true value of a company and hence fail to provide full and comprehensive information on the company to investors for them in making investment decisions. The Subcommittee has noted that while companies/listing applicants are required to comply with the legal requirements, SFC and HKEx has respective power under Section 38A(1) of CO and the Listing Rules to grant waivers to companies/listing applicants from strict compliance of the property valuation requirements on a case-by-case basis, and a number of large international corporations have successfully obtained such waivers and listed in Hong Kong. Hon James TO, Hon WONG Ting Kwong and Hon CHIM Pui-chung opine that even without the Amendment Notice, companies/listing applicants will still have an avenue to seek exemption from the valuation requirements. These members believe that should SFC and HKEx, as the regulators of the market, exercise their discretionary power in a reasonable, transparent and prudent manner, there will be greater flexibility in the exemption regime. Thus, the valuation cost burden on companies/listing applicants can be relieved without the risk of undermining investors' protection. However, if the proposed valuation and disclosure requirements are put in place, these members are concerned that SFC and HKEx may be constrained in exercising their discretionary power.

31. The Administration and SFC re-iterated at the Subcommittee meeting on 1 December 2011 that international accounting standards do not require valuation for properties that are part of non-property activities. Even if a valuation is obtained to comply with listing requirements, the book value based on cost rather than the valued amount, will still be used in the company's balance sheet and financial statements. Hence, there is no point in requiring valuation for such properties and no other major market has imposed the same requirement. The existing CO requirement for routine valuations of such properties is an anomaly arising from non-differentiation of properties and non-properties activities. The Amendment Notice seeks to remove this anomaly. The proposed amendment will bring Hong Kong closer to international requirements and offer a bright line test to give the market more certainty as to the requirements. But the requirements are still stricter than other jurisdictions. SFC has emphasized that the proposed amendment will be vital in enhancing Hong Kong's competitiveness as a preferred listing venue for international companies. The approach of granting case-by-case waivers is undesirable as a listing applicant will need to incur considerable amount of costs and time to put

together a well substantiated waiver application to demonstrate that the requirements are irrelevant, unduly burdensome, unnecessary or inappropriate, and there is no certainty that a waiver will be granted. SFC has expressed grave concern that potential listing applicants may be deterred from seeking listings in Hong Kong in the absence of a clear avenue to relief provided by the Amendment Notice. This would prevent HKEx from attracting listings of large international corporations.

32. At the Subcommittee meeting on 1 December 2011, Hon James TO was unconvinced and urged the Administration to repeal the Amendment Notice. The Administration and SFC appealed to members for supporting the proposed amendments. Hon James TO proposed that he, as the Subcommittee Chairman, would move a motion on behalf of the Subcommittee to repeal the Amendment Notice at the Council meeting of 14 December 2011. Hon WONG Ting-kwong and Hon CHIM Pui-chung supported Mr TO's proposal. The Subcommittee urged the Administration to reconsider its position, and agreed that if the Administration indicate on or before 6 December 2011 that it would move a motion to repeal the Amendment Notice, the Chairman would not proceed repealing the Amendment Notice. The deadline for giving notice to repeal or amend the Amendment Notice is 7 December 2011.

#### Verbal report by the Chairman on 2 December 2011

33. At the House Committee meeting held on 2 December 2011, Hon James TO gave a verbal report on the deliberations of the Subcommittee and members' decision for him to move a motion to repeal the Amendment Notice at the Council meeting of 14 December 2011. At the House Committee meeting, Hon WONG Ting-kwong said that it would be prudent for the Subcommittee to hold a further meeting with the Administration and SFC before proceeding with its decision to move a motion to repeal the Amendment Notice. He therefore requested Hon James TO to consider holding another Subcommittee meeting for the purpose. Hon James TO pointed out that if the Administration or SFC requested for holding another Subcommittee meeting, he would consider the request if there was a genuine need.

#### Urgent meeting held on 6 December 2011

34. Both the Administration and SFC wrote on 5 December 2011 to propose the Subcommittee to hold a further meeting. Upon request of Hon WONG Ting Kwong and Hon Alan LEONG, an urgent meeting of the Subcommittee was held on 6 December 2011. Members met with

representatives from the Administration, SFC, HKEx, and some market practitioners who are actively involved in the Hong Kong capital market ("market practitioners"). The Subcommittee also received written submissions from Asia Securities Industry & Financial Markets Association and Kirkland & Ellis expressing support for the proposals in the Amendment Notice.

35. At the meeting, SFC re-iterated that the Amendment Notice was the result of wide market consultation and the proposals therein had received overwhelming support from respondents. The Amendment Notice would benefit investors by enabling prospectuses to provide more focused information. There would still be valuation and disclosure requirements for properties that form part of property activities except for immaterial properties. The Amendment Notice would benefit Hong Kong as an international listing platform by removing valuation requirements for immaterial properties and properties which valuation was not needed in order for investors to form a valid view of the company. SFC stressed that no other international financial centre has a requirement for property valuations for each property regardless of its value, its materiality to the business or relevance of a valuation report to investors' assessment of the business. The Amendment Notice was designed to bring Hong Kong's requirements more in line with international practice but would still impose stricter requirements.

36. The market practitioners stressed that the proposals in the Amendment Notice, which focused on the valuation and disclosure requirements to material property interests, would be beneficial and necessary for Hong Kong to enhance its competitiveness as an international listing venue and bringing it in line with the requirements of other global financial centres. From their experience in assisting international companies to seek listing in Hong Kong, many overseas listing applicants had raised concern about the stringent and out-dated valuation requirements for properties in the Hong Kong regime, and this had deterred international companies from coming to the Hong Kong market. The existing valuation requirements are unnecessarily costly, time consuming and unduly burdensome, particularly in situations where a listing applicant has numerous property interests, of which not all of them are material to its business and the interests are in remote areas; property development and investment are not the applicant's core business; and the applicant has numerous operating leases which have no material value. The market practitioners pointed out that the proposals in the Amendment Notice would ultimately benefit investors, as information which is essential to investors will be presented in listing documents and circulars in a more

focused and meaningful manner. They advised that disclosing valuation reports for all property interests may result in pertinent information regarding material property interests being buried and not being readily apparent to investors or shareholders.

37. Hon James TO said that SFC and the Administration had already fully explained the benefits of the proposals to members during previous meetings. He said that he had requested SFC to consider including additional thresholds on disclosure requirement particularly in respect of companies' non-property activities interests. However, SFC had, after consideration, held the view that it was not necessary to change the present proposals. Hon James TO further said that at the Subcommittee meeting held on 1 December 2011, recognizing the importance of ensuring provision of full and comprehensive information to facilitate investors' decisions and noting the discretionary power of SFC and HKEx in granting waivers to companies/listing applicants from strict compliance of the property valuation requirements on a case-by-case basis, Subcommittee members were of the view that the waiver regime could provide greater flexibility without the risk of undermining investors' protection. It was under such circumstances that the Subcommittee decided at that meeting that the Amendment Notice should be repealed.

38. On the suggestion for SFC to continue with granting waiver to exempt companies from complying with the requirements, SFC re-iterated that the waiver approach could not replace the Amendment Notice. Other markets would still be able to contrast their more relevant and simple rules with those in Hong Kong. The market practitioners further pointed out that considerable amount of costs and time were involved in making waiver applications and listing applicants had also raised concern about the lack of certainty in obtaining waiver for their applications.

39. Referring to the 18 listed companies, Hon James TO considered that there was good justification to relax the valuation requirement for a company with numerous non-property activity interests and the aggregate amount only represented a minimal portion of the company's total assets, such as the case of the Mainland bank which had over 46 000 properties that in total represented less than 2% of its total assets (Company 6 in Appendix II). However, he had strong reservation about applying the relaxed requirement to a company with non-property activities interests and the aggregate amount of those interest represents a substantial portion of the company's total assets. The three companies with non-property activities interests amounted to over 30% of the companies' total assets was a case in point (Companies 10 - 12 in Appendix II). Hon James TO

considered that valuation information on these substantial amount of property interests was material information for investors and should be included in the prospectuses. Hence, he urged SFC to reconsider the proposed thresholds on valuation and disclosure requirement to address his concern. He remarked that while he supported in principle the direction of the proposals in the Amendment Notice to relax the present stringent requirements, he considered that it would be prudent to implement the proposals in a gradual manner. With the repeal of the Amendment Notice, SFC would reconsider the proposals and introduce a new Amendment Notice which would address his concern.

40. The Administration and SFC stressed that the basic principle in the proposals was to differentiate property and non-property activities interests of companies with reference to how a certain property is used by the companies and the core business of the companies, so that different valuation and disclosure requirements could be applied and as a result would enable investors to focus on the material information. Hon James TO's suggestion of revising the proposed thresholds would not meet the ultimate objective of imposing valuation requirement on material property interests only and bringing the Hong Kong regime more in line with those of other major financial centres.

41. Hon WONG Ting-kwong pointed out that the views and experience from the market practitioners were very helpful in enhancing members' understanding on the concerns raised by overseas listing applicants and the ultimate objective of the proposals in the Amendment Notice. He said that at previous meetings, SFC and the Administration had mainly emphasized the benefit of the proposals in reducing wastage of paper. Having considered the views from the market practitioners and the explanation from SFC and the Administration at the meeting on 6 December 2011, he agreed to the principle enshrined in the proposals that factors including the core business of a company and the use of a property by the company were essential in determining the valuation requirement on the property interests.

42. Hon Alan LEONG noted that major overseas markets had even more relaxed property valuation requirements, especially for non-property activities interests, than those in Hong Kong. While recognizing the need for Hong Kong's requirements to be in line with those in global financial markets, he considered it important to have sufficient safeguards to protect investors' interests. In response, SFC stressed that notwithstanding the Amendment Notice, companies/listing applicants had a general disclosure obligation under CO and Listing Rules to provide information material to investors' assessment in a prospectus. Failure to provide material

information could result in civil and criminal liabilities. HKEx emphasized that every listing application was vetted by the Listing Committee in a careful manner and listing documents and circulars were subject to requirements under the dual filing system. Companies and market practitioners involved in the listing process would have civil and criminal liabilities for failure to provide material information in listing documents and circulars and making untrue statements.

43. Having considered the views from the market practitioners and the explanation from SFC and the Administration at the meeting on 6 December 2011, Hon WONG Ting-kwong moved the following motion:

"That this Subcommittee reverses the decision made at the meeting on 1 December 2011; and that the Chairman of the Subcommittee will not move a motion to repeal the Amendment Notice on behalf of the Subcommittee at the Council meeting on 14 December 2011."

The motion was put to vote. Two members voted for and one member voted against the motion. The motion was passed.

44. Hon James TO remained unconvinced by the explanation of SFC and the Administration. He indicated that he would move a motion in his own name to repeal the Amendment Notice at the Council meeting on 14 December 2011.

### **Advice sought**

45. At the House Committee meeting on 2 December 2011, the Subcommittee Chairman made a verbal report on the deliberations of the Subcommittee. Members are requested to note the deliberations of the Subcommittee in this written report.

**Subcommittee on  
Companies Ordinance (Exemption of Companies and Prospectuses  
from Compliance with Provisions) (Amendment) Notice 2011**

**Membership list**

|                      |  |
|----------------------|--|
| <b>Chairman</b>      | Hon James TO Kun-sun   |
| <b>Members</b>       | Hon WONG Ting-kwong, BBS, JP<br>Hon CHIM Pui-chung<br>Hon Alan LEONG Kah-kit, SC<br><br>(Total: 4 members) |
| <b>Clerk</b>         | Ms Connie SZETO  |
| <b>Legal Adviser</b> | Miss Evelyn LEE  |
| <b>Date</b>          | 11 November 2011   |

## Appendix II

### Information on property interests of some companies listed in Hong Kong from 2008-2010

|  | Total property interests / total assets | Number of individual property interest | Number of jurisdictions | Proposed Exemption    |                                  |          |
|--|---|--|-------------------------|-----------------------|----------------------------------|----------|
|  |   |  |                         | Full valuation report | Summary of full valuation report | Overview |
| <b>Companies with non-property activities</b>              |   |  |                         |                       |                                  |          |
| Company 1  | 11.7%                                   | 413                                    | 30                      | -                     | -                                | 413      |
| Company 2  | 7.5%                                    | 527                                    | 34                      | -                     | -                                | 527      |
| Company 3  | 1.3%                                    | 2,500                                  | 30                      | -                     | -                                | 2,500    |
| Company 4  | 1.4%                                    | 333                                    | 13                      | -                     | -                                | 333      |
| Company 5  | 0.3%                                    | 680                                    | 14                      | -                     | -                                | 680      |
| Company 6  | 1.3%                                    | 46,067                                 | 9                       | -                     | -                                | 46,067   |
| Company 7  | 7.8%                                    | 877                                    | 27                      | -                     | -                                | 877      |
| Company 8  | 14.5%                                   | 19,907                                 | 12                      | -                     | -                                | 19,907   |
| Company 9  | 1.8%                                    | 4,735                                  | 2                       | -                     | -                                | 4,735    |
| Company 10   | 33.4%                                   | 75                                     | 2                       | -                     | -                                | 75       |
| Company 11   | 34.4%                                   | 113                                    | 2                       | -                     | -                                | 113      |
| Company 12   | 36.9%                                   | 92                                     | 1                       | -                     | -                                | 92       |
| <b>Companies with property activities</b>                  |   |  |                         |                       |                                  |          |
| Company 13   | 75.3%                                   | 95                                     | 5                       | 1                     | 49                               | 45       |
| Company 14   | 50.6%                                   | 43                                     | 2                       | 6                     | 13                               | 24       |
| Company 15   | 77.5%                                   | 37                                     | 1                       | 6                     | 12                               | 19       |
| Company 16   | 87.9%                                   | 12                                     | 1                       | 7                     | 3                                | 2        |
| Company 17   | 75.4%                                   | 98                                     | 2                       | 3                     | 43                               | 52       |
| <b>Companies with property and non-property activities</b> |   |  |                         |                       |                                  |          |
| Company 18   | 34.6%                                   | 134                                    | 1                       | 6                     | 14                               | 114      |

#### Key assumptions

1. "Total property interests" is estimated base on different information disclosed in the financial statements of each listing applicant. The estimated figures may include items that are not related to property interests.
2. The analysis is based on valuation amount of individual property as carrying amount is not disclosed in the prospectus. Given that valuation amount is usually higher than carrying amount, individual property interests that require valuation may be less.

Source: Extract from LC Paper No. CB(1)462/11-12(02). Information provided by the Securities and Futures Commission.